

This exposure draft presented by Labuan FSA is intended to promote fair, transparent and ethical practices by financial intermediaries that undertake digital financial services in Labuan International Business and Financial Centre [i.e. referred to as Labuan Digital Financial Intermediaries (DFIs)]. A good code of market conduct would serve to safeguard stakeholders' interest, maintain market integrity and promote trust and confidence particularly within the emerging sector like digital financial business.

Labuan FSA welcomes and values feedback on the requirements of the exposure draft. The comments or inputs may encompass suggestions, recommendations and alternatives, which should be supported with clear rationale, practicality and relevance for Labuan FSA's consideration.

Feedback shall be submitted electronically to Labuan FSA by 31 October 2023 to the following officers:

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## **GUIDELINES ON MARKET CONDUCT FOR LABUAN DIGITAL FINANCIAL INTERMEDIARIES**

### **1.0 Introduction**

- 1.1 The rapid advancements of technology has transformed the financial landscape through innovation and greater efficiency. The adoption of digital technology within the financial services has brought convenience, efficiency, and inclusivity to the financial sector. As such, there is a need to ensure sound practices to protect clients from unfair practices, misinformation, and predatory behaviours. A good market conduct practices would serve to enhance market integrity and confidence for the long-term sustainability and reputation of the financial market.
- 1.2 In this regard, the *Guidelines on Market Conduct for Labuan Digital Financial Intermediaries* (the Guidelines) provides the minimum requirements on market conduct practices to be adhered by Labuan financial intermediaries undertaking digital financial services (DFS) in Labuan International Business and Financial Centre (Labuan IBFC) [i.e. referred to as Labuan Digital Financial Intermediaries (DFIs)].

### **2.0 Applicability**

- 2.1 The Guidelines is applicable to any DFI licensed and approved by Labuan Financial Services Authority (Labuan FSA) as follows:
  - (i) Labuan money-broking business and Islamic money-broking business licensed under Part VI of the Labuan Financial Services and Securities Act 2010 (LFSSA) and Part VI of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA), respectively;

- (ii) Labuan fund managers licensed under Part III of the LFSSA and Part IV of the LIFSSA;
  - (iii) Labuan securities licensees and Islamic securities licensees licensed under Part IV of the LFSSA and Part V of the LIFSSA, respectively;
  - (iv) Labuan credit token business and Islamic credit token business licensed under Part VI of the LFSSA and Part VI of the LIFSSA, respectively;
  - (v) Labuan exchanges established under Part IX of the LFSSA; and
  - (vi) Labuan payment system established under Part XI of the LFSSA and Part XII of the LIFSSA.
- 2.2 Labuan FSA may specify and direct other Labuan financial institutions that undertake DFS to observe the requirements of the Guidelines where relevant.
- 2.3 The Guidelines are to be read together with the requirements under relevant guidelines issued by Labuan FSA as set out in **Appendix I**.

**Question 1:**

Does the proposed Guidelines sufficiently cover the type of licensees listed under paragraph 2.1?

### **3.0 Legal Provision**

- 3.1 The Guidelines is issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA) to specify the minimum prudential standards to be implemented by the DFI.
- 3.2 Any person who fails to comply with the Guidelines may be subject to an administrative penalty and/or other enforcement actions provided under Section 36B and Section 36G of the LFSAA.

## 4.0 Regulatory Requirements

- 4.1 The application and observance of the principles specified under the Guidelines is to be achieved by a DFI through the minimum requirements and to be complemented by the recommended best practices:
- (i) Minimum requirements must be complied with by all DFIs. For completeness, these applications may refer to relevant regulatory requirements that have been issued by Labuan FSA as set out in **Appendix I**; and
  - (ii) The best practices are broad guidance on other more advanced market conduct practices commonly observed in international markets. Although these best practices are not made mandatory, DFIs are encouraged to adopt them as their digital financial business operations grow and mature over time.

## 5.0 Effective Date

- 5.1 The Guidelines shall come into effect on **1 January 2025**, and would remain effective and applicable unless amended or revoked. Notwithstanding this, DFIs which intend to early adopt the requirements of the Guidelines are permitted to do so prior to the effective date.

**Question 2:**

Do you foresee any challenges with the effective date of the Guidelines vis-à-vis the compliance to its requirements? If yes, please provide details.

## 6.0 Definitions

<b>Digital Financial Services (DFS)</b>	The provision of services by DFI to clients that is delivered via electronic channels including the Internet and mobile devices.
<b>Digital Financial Intermediaries (DFIs)</b>	Refers to Labuan Financial Institutions listed under paragraph 2.1 that are undertaking or providing DFS to their clients including dealing with digital assets.
<b>Senior Management</b>	Refers to the principal officer, any officer(s) or committee performing a senior management function who are principally accountable for:  (a) Making decisions that affect the whole, or a substantial part of, the DFI's business;  (b) Implementing and enforcing policies and strategies approved by the Board including the Head of Department or any equivalent designated person; or  (c) Internal controls or other key functionaries of the DFI which include compliance, AML/CFT compliance, Shariah advisory, internal audit, and risk management.
<b>Client</b>	Refers to any person for whom or on whose behalf the DFI provide services in the course of carrying out digital financial activities.
<b>Client Asset</b>	Refers to client digital assets and client money that is received or held on behalf of the DFI.
<b>Client Digital Asset</b>	Refers to a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes but does not include a digital representation of fiat currencies.

<b>Client Money</b>	Refers to money paid to, held or received by the DFI on behalf of the client for the provision of services by the DFI.
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## 7.0 Integrity and Ethics

**Principle 1: The DFI shall at all times act honestly and in a transparent manner when dealing with their clients.**

### Minimum Requirements

- 7.1 The DFI is required to establish policies and procedures to prevent engaging in any activities that intentionally disrupt the fair operation of the digital asset market. This includes manipulation or any other conduct that directly or indirectly aims to create false or misleading appearances regarding the manipulation of market prices for digital assets or any financial instrument.
- 7.2 The policies and procedures include but not limited to the following:
- (i) Conduct its business with integrity at all times, acting with due care, skill and diligence. It must deal fairly with all clients and avoid misleading and deceptive acts or representation, both before the inception of the contractual arrangement and through to the point at which all obligations under a contract have been satisfied;
  - (ii) Shall not unfairly prioritise their own interests above their clients by ensuring that the business is conducted in a manner which is not intended to benefit themselves at the expense of their clients' interest; and
  - (iii) Act competently and diligently in regard to all transactions between themselves and their clients. This includes ensuring that all transactions or decisions entered into or taken by or on behalf of clients are appropriately authorised and handled by persons with an appropriate level of knowledge, experience, and status.

- 7.3 As the DFI is responsible for providing professional advice or exercising discretion on behalf of their clients, they must be able to demonstrate that the advice, or exercise of discretion, are appropriate for their clients' needs. In addition, the DFI must not omit, diminish, or obscure material information or warnings which may result in the information being insufficient, unclear, or misleading. In this regard, the DFI needs to:
- (i) provide the client with relevant information that is adequate, up-to-date and material to make a balanced and informed decision; and
  - (ii) provide clients with a full and fair account of the fulfilment of its contractual responsibilities, when requested by them.
- 7.4 The DFI would need to provide appropriate training to all relevant employees in a timely manner to ensure adherence to acceptable and unacceptable behaviours as specified under paragraph 7.0.

### **Best Practices**

1. In relation to paragraph 7.4, the DFI may provide appropriate training to all relevant employees on a yearly basis.

## 8.0 Handling Clients' Information

**Principle 2: The DFI shall have procedures in place to handle the information of their clients and ensure that records are maintained in an appropriate manner.**

### Minimum Requirements

8.1 In handling the information of their clients, the DFI is required to:

- (i) take reasonable care that the information is accurate in all material respect, not misleading and easily understandable; and
- (ii) have adequate procedures for the maintenance, security, privacy and preservation of records, working papers and documents as well as reasonably safeguarded against loss, unauthorised access, alteration or destruction. This includes but not limited to the following:
  - (a) Ensure proper provision for holding, having access to and sharing of information, including ensuring that there is an adequate, effective and appropriate mechanism in place for information to be made available to all the relevant authorities and there should be no barrier to the appropriate flow of information to the authorities as permitted under the law;
  - (b) Maintain all records on a continual basis so that they are accessible and up-to-date at all times as far as is reasonably practical;
  - (c) Treat information relating to the deals transacted or being transacted as confidential and limit access to such information; and
  - (d) Adequate records identifying relevant financial transactions should be kept following the termination or the cessation of the business relationship with the client for a minimum period as specified under the law applicable in Labuan IBFC from the last of these events.

## Best Practices

1. Personnels who have access to the DFI's confidential information should be advised in writing upon engagement. Further, the DFI should provide periodic reminders thereafter of confidentiality issues.

## 9.0 Protection and Segregation of Client Money and Client Assets

**Principle 3: The DFI shall have mechanism in place to ensure that any assets belonging to clients are kept segregated from the DFI's own assets.**

### Minimum Requirements

- 9.1 The DFI is required to keep client's monies accounts separate from its own account and mark in the books of the DFI relating to each client's account. Such monies shall at no time be mixed with the general assets of the DFI. The client's monies shall be readily identified at any time. In this regard, any withdrawal of client's monies is expected to be completed within three (3) working days from the date of the client's withdrawal request.
- 9.2 The DFI shall maintain proper record of the client's monies accounts. The balance of client's monies accounts needs to be reconciled with internal records and clients' records on a monthly basis so as to ensure accuracy and consistency.
- 9.3 The DFI shall ensure appropriate and effective procedures are in place to protect the client assets from theft, fraud and other acts of misappropriation. In the handling of client transactions and client assets, the DFI is required to ensure that the client assets are safeguarded from conversion or inappropriate use by any person.

- 9.4 In order to enhance the security of client assets storage, the DFI is required to undertake risk assessment on the storage methods, considering the evolving landscape of security threats and technological advancements.
- 9.5 The DFI is required to have clear processes in place to minimise the risks associated with managing deposits and withdrawals of clients' money. This includes whether:
- (i) deposits and withdrawals are performed using hot, cold, or other storages;
  - (ii) withdrawals are processed real time or only at certain cut-off times;
  - (iii) withdrawals process is automatic or involves manual authorisation; and
  - (iv) when to suspend irregular deposits and withdrawals to conduct investigations.
- 9.6 The DFI shall establish system and controls for maintaining accurate and up-to-date records of clients' assets held which includes a robust process to prepare, review and approve reconciliations of client assets in a timely and efficient manner to identify and address for any errors, omissions or misplacements of client assets. This includes but not limited to the following;
- (i) Transaction timestamp;
  - (ii) Details of any transaction including the purpose of a transfer, amount, and details of counterparty;
  - (iii) Relevant signatories and transaction approval / rejection evidence;
  - (iv) Account balances; and
  - (v) Transaction value.
- 9.7 In the situation where a transaction cannot be completed immediately or may be delayed until the next business day, the client monies should be kept in separate bank wallet addresses and clearly labelled as client monies. This is to ensure that client money is protected from the threat posed by insolvency or liquidation of the DFI.

## **Best Practices**

1. The DFI may place client assets in a trust with a qualified custodian. The DFI may acquire indemnity insurance or implement alternative arrangements to ensure the return of client assets in the event the DFI is placed into liquidation, becomes insolvent or is a victim of theft.

### ***Question 3:***

In relation to paragraph 9.1, do you foresee any challenges to complete the client withdrawal request within three (3) working days from the date of the client's withdrawal request?

### ***Question 4:***

Do you foresee any challenges on the implementation of the above requirements on the protection and segregation of client money and client assets as prescribed under paragraph 9.0? If yes, please provide details.

### ***Question 5:***

Any recommendation on the Best Practices by the industry to be included in this part?

## 10.0 Disclosure of Information

**Principle 4: The DFI shall make clear and adequate disclosure of relevant material information in dealings with their clients.**

### Minimum Requirements

10.1 DFI is required to provide sufficient notice to their clients before effective changes of the following:

- (i) Fees, charges and interest rates;
- (ii) Material modifications to or discontinuation of products or services; and
- (iii) Material change to the terms and conditions of any services provided by the DFI, which includes any amendment to policies applicable to the client's account.

10.2 DFI is required to provide clients with clear instructions on reporting suspected fraud or other security breaches on their account. Details of the contact information for such reporting shall be easily accessible.

10.3 DFI is required to disclose the following to their clients:

- (i) the nature and risks that clients may be exposed to in trading of the digital assets; and
- (ii) the custodial arrangements in relation to client assets held on their behalf, including the rights and obligations of each party and how the client assets are stored.

## 11.0 Conflict of Interest

### **Principle 5: The DFI shall identify and effectively manage conflicts of interest.**

#### **Minimum Requirements**

- 11.1 DFI is required to establish the policies and procedures to manage issues of conflict of interest including potential conflicts of interest, effectively and efficiently. This includes:
  - (i) identifying, monitoring, mitigating and managing situations and potential situations which may give rise to conflict of interest;
  - (ii) requiring disclosure of any conflict or potential conflict of interest to the clients; and
  - (iii) preventing sharing of confidential information with unauthorised persons who stand in a conflict position (e.g. personnel in the dealing department).
- 11.2 In the situation where conflicts of interest cannot be avoided, the DFI shall keep adequate records and take all reasonable steps to manage and prevent them from damaging the interests of clients. Priority to the clients' interest must be given if there is a conflict between the clients' interests and its own interest.

#### **Best Practices**

1. The DFI may consider to establish and ensure a clear policies which set out the circumstances under which the acceptance of gifts, rebates or benefits from clients or other counterparties are allowed and the corresponding approval required.

## 12.0 Prevention of Market Manipulative and Abusive Activities

**Principle 6: The DFI must not carry out or facilitate any transactions that would affect the fair and orderly operation of the market.**

### Minimum Requirements

- 12.1 The DFI is required to establish the policies and procedures for proper surveillance of trading activities in order to identify, prevent and report any market manipulative or abusive trading activities. This includes the following but not limited to:
  - (i) Identifying and detecting anomalies, which includes performing periodic independent reviews of suspicious price spikes;
  - (ii) Monitoring and preventing any potential use of abusive trading strategies; and
  - (iii) Taking immediate steps to restrict or suspend trading upon discovery of manipulative or abusive activities (e.g. temporarily suspending accounts).
- 12.2 The DFI is required to adopt market surveillance system to identify, monitor, detect and prevent any market manipulative or abusive activities on its trading platform. The effectiveness of the market surveillance system shall be reviewed on a periodic basis.
- 12.3 In relation to proprietary trading in virtual asset, DFI shall not:
  - (i) Engage for its own account or any account in which it has an interest;
  - (ii) Engage in market-making activities on a proprietary basis; and
  - (iii) Conduct any proprietary trading for any corporations within the same group of companies through the DFI (whether on-platform or off-platform).

- 12.4 Upon becoming aware of any actual or potential market manipulative or abusive activities, DFI is required to notify Labuan FSA as soon as practicable to the following:

Director  
Supervision Department  
Labuan Financial Services Authority  
Level 17, Main Office Tower  
Financial Park Complex  
Jalan Merdeka  
87000 Federal Territory of Labuan, Malaysia

Telephone no: 03 8873 2000  
Facsimile no: 03 8873 2209

Email: [sed@labuanfsa.gov.my](mailto:sed@labuanfsa.gov.my)

### **Best Practices**

1. In relation to paragraph 12.2, the DFI may review the market surveillance system at least annually.

#### **Question 6:**

Do you foresee any challenges in the adoption of the market surveillance system as prescribed under paragraph 12.2? If yes, please provide details.

## 13.0 Terms of Business

**Principle 7: The DFI shall have written client agreement with each and every client before services are provided to the client.**

### Minimum Requirements

- 13.1 The DFI is required to disclose terms and conditions with each prospective client and maintain the terms of agreements with each client, including evidence of the client's agreement to those terms.
- 13.2 The client agreement shall include the following but not limited to:
  - (i) Description of the services to be provided;
  - (ii) Description of any remuneration (and the basis for payment) that is to be paid by the client to the DFI;
  - (iii) The fees to be charged and the basis of the calculation of those fees;
  - (iv) Any exit fee and the basis upon which it is calculated;
  - (v) Description of any provisions for the termination of the agreement and the consequences of termination;
  - (vi) The DFI to be continue to be responsible to its client until such time the relationship is terminated. The DFI should only terminate a relationship with its clients on a reasonable notice.
- 13.3 The DFI shall inform the client on any changes to the terms and conditions during the relationship and throughout the product lifecycle, using an appropriate communication channel and per the agreed terms and conditions.

## 14.0 Advertising and Promotions

**Principle 8: DFI shall promote products and services in a manner that is clear, fair and not misleading.**

### Minimum Requirements

14.1 The DFI shall ensure that its advertisements:

- (i) Do not contain a statement, promise or forecast that is untrue, misleading or deceptive;
- (ii) Are not designed in such a way to distort or conceal any relevant subject material;
- (iii) Are clearly recognised as advertisements;
- (iv) Use clear and easy to understand language; and
- (v) Include a statement of the related risks.

## 15.0 Complaints Handling

**Principle 9: The DFI shall have policies and procedures in place to ensure client's complaints are properly handled and dealt with on a timely basis.**

### Minimum Requirements

15.1 The DFI is required to provide clients the appropriate and accessible means to file their complaints, along with clear instructions. Notwithstanding this, this shall not limit clients to only submitted complaints through one channel or in one form in order to be recognised as a complaint.

- 15.2 The DFI shall establish a dedicated complaint handling system to ensure all complaints received are reviewed and where necessary, actions are taken to address valid complaints on a timely manner. The complaint handling system shall incorporate the following:
- (i) A log system to register all complaints received with the assignment of a reference number upon each complaint;
  - (ii) Categories of all complaints received;
  - (iii) Procedure manual to ensure consistency and standardised approach in handling of complaints;
  - (iv) Proper filing of all correspondences in regard to complaints investigation;
  - (v) Reports to Senior Management with regard to the statistic/data of complaints received; and
  - (vi) Client charter that would include, amongst others, the time frame for the following phases of complaints review:
    - (a) Acknowledgement of receipt;
    - (b) Time required to respond on whether the DFI is pursuing the complaint or not;
    - (c) Time required in resolving a particular type of complaints (given its complexity); and
    - (d) Periodic correspondence to complainant to inform on the status of the complaint where it is not addressed and resolved within a specified period of time.
- 15.3 The DFI shall not impose any fees or charges for the submission or handling of any complaints.

## **Best Practices**

1. The DFI may consider having a reasonable period of time in resolving all complaints promptly. For example:
  - (i) Acknowledge all complaints within one (1) week of a complaint being made; and
  - (ii) Resolve all complaints within four (4) weeks and no later than eight (8) weeks from when the complaint was made.

### **Question 7:**

If you have comment(s) / recommendation(s) on any matters relevant to be considered in finalising the proposed Guidelines, please provide details.

## **APPENDIX I LIST OF POLICY DOCUMENTS TO BE READ TOGETHER WITH THE GUIDELINES**

1. The Guidelines are to be read together with the following guidelines:
  - (i) Guidelines on Carrying Out Money Broking Business in Labuan IBFC;
  - (ii) Guidelines on the Establishment of Labuan Fund Manager;
  - (iii) Guidelines on the Establishment of Labuan Securities Licensee including Islamic Securities Licensee;
  - (iv) Guidelines on Fit and Proper Person Requirements;
  - (v) Guidelines on Compliance Function for Labuan Licensed Entities;
  - (vi) Guidelines on External Service Arrangements for Labuan Financial Institutions;
  - (vii) Guiding Principles on Business Continuity Management;
  - (viii) Guidelines on Digital Governance Framework;
  - (ix) Guidelines on Technology Management;
  - (x) Guidelines on Anti-Money Laundering, Countering Financing of Terrorism and Targeted Financial Sanctions for Labuan Key Reporting Institutions; and
  - (xi) Circular on Principles on Electronic Know-Your-Customer (e-KYC) for Digital Financial Services.